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TO RUEHC/SECSTATE WASHDC PRIORITY 0404

INFO RUEHLO/AMEMBASSY LONDON PRIORITY 1893

RUEHKO/AMEMBASSY TOKYO PRIORITY 3252

RUEHBJ/AMEMBASSY BEIJING PRIORITY 9219

RUEHWL/AMEMBASSY WELLINGTON PRIORITY 5488

RUEHGP/AMEMBASSY SINGAPORE PRIORITY 1590

RUEHDN/AMCONSUL SYDNEY PRIORITY 3916

RUEHPT/AMCONSUL PERTH PRIORITY 3979

RUEHBN/AMCONSUL MELBOURNE PRIORITY 5707

RUEHBS/USEU BRUSSELS PRIORITY

RHEHNNSC/NSC WASHINGTON DC PRIORITY

RUCPDOC/DEPT OF COMMERCE WASHINGTON DC PRIORITY

RUEATRS/DEPT OF TREASURY WASHINGTON DC PRIORITY

UNCLAS SECTION 01 OF 02 CANBERRA 001079

SIPDIS

SENSITIVE

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TAGS: EFIN ECON ETRD AS

SUBJECT: AUSTRALIAN DOLLAR TAKES A DIVE

REF: A. CANBERRA 1020

1B. CANBERRA 1036

11. (SBU) Buffeted by falling commodity prices, fear of global economic recession, and dropping domestic interest rates, the Australian dollar has lost 37% of its value against the U.S. dollar, falling faster since July than even the Icelandic krona. The Aussie dollar has lost 27% of its trade-weighted value over three months, hitting a five-year low against the US dollar and a seven-year low against the Japanese yen. We expect the Australian dollar to remain vulnerable into next year, with high levels of volatility such as on October 24, when the currency fluctuated 10% over the course of the day.
End summary.

Aussie Dollar Dives

12. (SBU) Predictions of possible parity for the Australian dollar against the US greenback - it peaked at US\$.985 in early July - have vanished as the Australian dollar has plummeted 37% against the US dollar (27% in trade weighted terms against a currency basket maintained by the Reserve Bank of Australia) in under four months. Since July 4, it has fallen faster against the US dollar than the Icelandic krona or the Brazilian real, dropping to a five-year low of US\$.605 on October 24, before recovering slightly to US\$.617 on October 27. Against the yen, the Australian dollar on October 24 closed at its lowest level since mid-2001, Y62.05 - down 40% from Y104.17 on July 21, driven in part by the repatriation of Japanese investment funds following steep declines in Japanese share prices. The Australian dollar is also down against the Euro (18%) and pound sterling (16%) from its July peaks.

13. (SBU) Australian media reported October 27 that the Reserve Bank of Australia (RBA) entered the currency market on October 24 and 27 to buy Australian dollars. According to press reports, the RBA initially acted to ensure liquidity in an environment when sellers significantly outnumbered buyers. However, on October 27, the RBA appears to have acted when the AU\$ fell below US\$.6125. Several market contacts confirmed their understanding that the RBA has been active in ensuring AU\$ liquidity. One noted reports that the Bank of Japan has also been active in selling AU\$ in Tokyo, perhaps as part of a swap line with the RBA.

Reasons Why

14. (SBU) Several factors have driven the Australian dollar down from its July heights. Probably the most important has been the recent drop in global commodity prices - a key factor for the currency of an economy in which commodities comprise 60% of exports. The strong feeling here is that a global economic slowdown will further dampen commodity prices and hit the Australian economy; the inflation fears of just a couple of months ago have now morphed into worries about growth and unemployment. Dropping Australian interest rates over the past three months have also reduced the allure of the Australian dollar for international investors. And finally, many such investors in the current uncertain financial and economic climate are cashing out, preferring to park their assets in the safer US dollar. Qpreferring to park their assets in the safer US dollar.

Return of the Pacific Peso?

15. (SBU) This sustained drop is the biggest sell-off since the Australian dollar was floated in 1983, causing some commentators to joke bitterly about the return of the "Pacific Peso" - although nobody seems to expect the dollar to drop to the US\$.478 trough it reached in 2000. With global commodity prices expected to fall further (septel) and more interest rate cuts expected as soon as November 4, the Australian dollar will likely remain vulnerable well into next year. Although Australians are finding their vacations in the US and Europe more expensive than expected, most commentators and industry have expressed cautious satisfaction with the drop of the Aussie dollar. Contract

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prices for commodities are likely to fall significantly in US\$ terms in 2009, but local producers will see less of a drop in Australian dollar terms. Import costs, important to Australia's mining and manufacturing sectors, have also risen sharply and there are few domestic substitutes for many manufactured imports, but on balance the expectation is the weaker dollar will benefit exporters, if not consumers.

Comment

16. (SBU) The rapid fall of the Australian dollar, the world's sixth most heavily traded currency (after the US dollar, the euro, the yen, the UK pound and the Swiss franc), reflects the perception that Australian interest rates will continue to drop and that commodity prices will continue to fall, possibly dragging Australia into recession. The Australian economy still has some advantages going into the anticipated global economic recession, including low unemployment, budgetary surpluses, and a sound banking sector. But given Australia's reliance on commodity exports, the longer-term picture will be heavily influenced by what happens in Australia's top trading partner China - and China's top export market, the United States. End comment.

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